

IN THE

**United States Circuit Court of Appeals**

**For the Ninth Circuit** 2

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EDNA SMART SHERMAN,

*Petitioner,*

VS.

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

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**BRIEF FOR PETITIONER.**

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FILED

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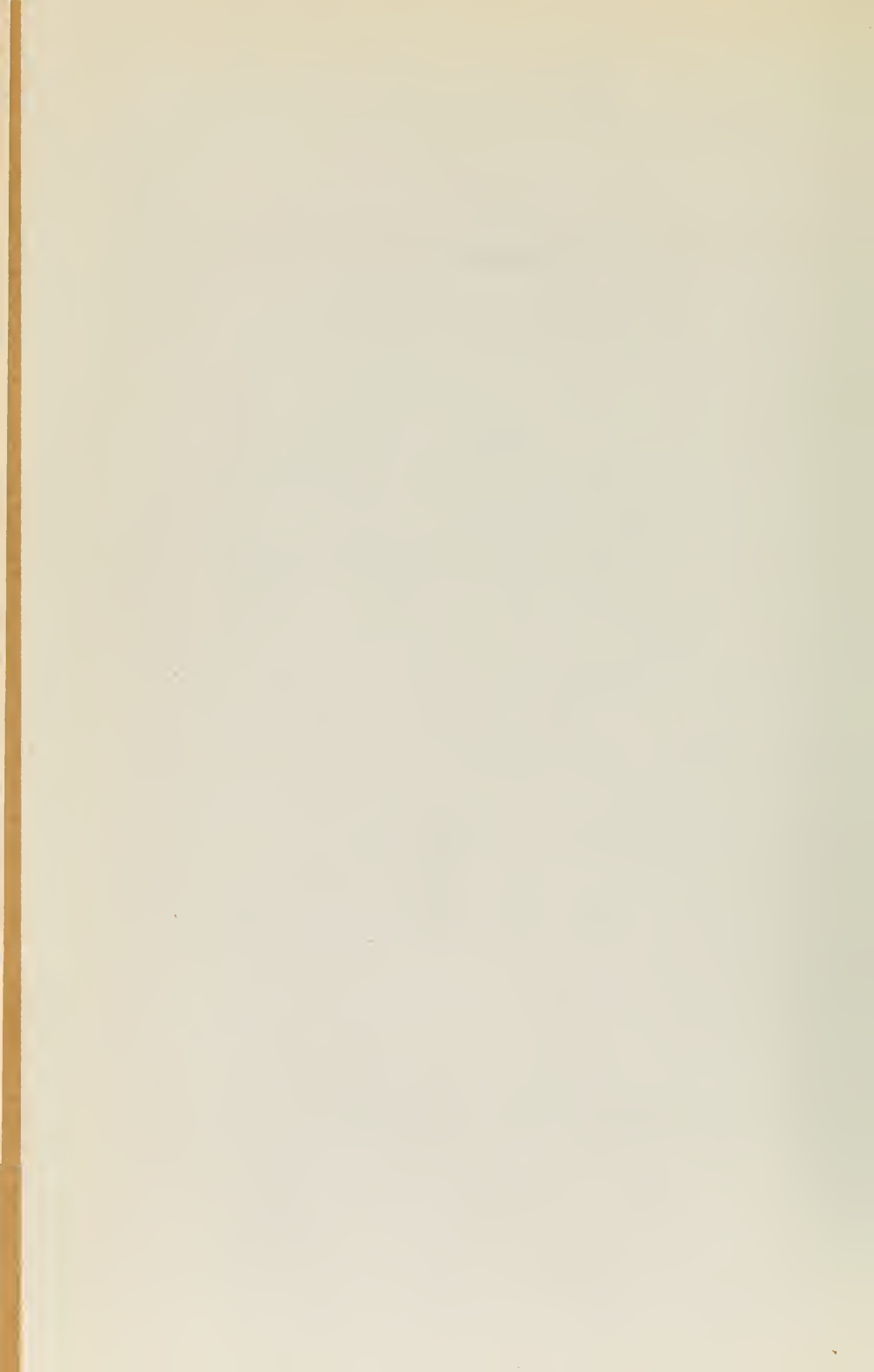
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No. 7483

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## BRIEF FOR PETITIONER.

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### STATEMENT OF THE CASE.

This is a petition for a review of a decision of the United States Board of Tax Appeals entered December 28, 1933, approving a deficiency in income tax of the petitioner for the calendar year 1929, in the amount of \$7,243.90.

The following facts appear from the record:

The petitioner and Frederic R. Sherman are, and for many years have been, husband and wife, each residing and domiciled, though apart, in the State of California. In the year 1926 the petitioner and her husband separated and thereupon entered into a separation agreement dated May 12, 1926 (Transcript pp.

29-32), which was later modified by an agreement dated February 11, 1927 (Transcript pp. 33-35). By said agreements petitioner and her husband defined and determined their respective rights and interests in and to all of the property of the husband, both real and personal, community and separate. It was the intention of petitioner and her husband by said agreements to terminate the community interest of the petitioner in and to any part of the earnings of her husband thereafter accruing. The petitioner and her husband have lived separately and apart ever since March, 1926, though they have not been divorced. Such was their relationship during the taxable year 1929, and such it is at this time.

The transfers agreed to be made in the agreements were made and the monthly payments of \$1,000 each therein provided to be made by the husband to petitioner were made up to the calendar year 1929 (Transcript p. 47). During the year 1929 petitioner received only three of these payments, or \$3,000 (Transcript pp. 50-51). Petitioner received no other money or property of any kind from her husband during the taxable year 1929. Her husband's salary during that year was \$22,500 which, in conformity with the separation agreements, he reported as taxable income, paying a tax thereon (Transcript p. 63). Similarly, the petitioner did not return any portion of this salary.

The Commissioner has determined that one-half of the salary earned by the husband of the petitioner, Frederic R. Sherman, during the calendar year 1929 was taxable to the petitioner.

Upon the foregoing facts the Board of Tax Appeals held that the Commissioner was correct in taxing to petitioner one-half of the salary earned by her husband during the calendar year 1929 (Transcript pp. 37-40). The Board of Tax Appeals thereupon entered an order of "a deficiency of \$7,243.90 for the year 1929" (Transcript p. 41). From the order so entered the petitioner petitioned this Court for review (Transcript pp. 41-46).

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#### **SPECIFICATION OF ERROR.**

The United States Board of Tax Appeals erred in affirming the determination of the Commissioner of Internal Revenue that one-half of the salary of the husband of the petitioner, Frederic R. Sherman for the year 1929 was taxable to the petitioner, for the reason that petitioner's community interest therein was theretofore severed by contract.

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#### **ARGUMENT.**

**THE RULE LAID DOWN IN THIS CASE IS CONTRARY TO OTHER SUBSEQUENT DECISIONS OF THE BOARD AND TO THE LAW OF THIS CIRCUIT.**

The decision of the Board of Tax Appeals in this case was that husband and wife residing in California could not by contract terminate their respective community interests in the earnings of the other thereafter to accrue, to the end that no tax would be payable by one spouse for the salary earned

by the other. Although the petitioner had by contract severed her community interest in her husband's future earnings, the Board held that she nevertheless should pay a tax upon one-half of the husband's salary for the year 1929. During the time the instant action was pending and since the Board's decision therein, however, it was held to the contrary in three cases (*Grant v. The Commissioner*, 29 B. T. A. 760; *Skewes-Cox v. The Commissioner*, 29 B. T. A. 167; *Helvering v. Hickman*, 27 B. T. A. 807), and the question has been similarly determined by this court of appeals in affirming the *Hickman* decision (*Helvering v. Hickman* (1934) 70 Fed. (2d) 985).

We submit, therefore, that the settled law of this circuit now is that husband and wife can by contract change their interest in each other's future personal earnings, to the end that the salary of the husband or the wife, as the case may be, does not thereafter become community property, taxable to both equally, but, on the other hand, remains the separate property of the one earning it and is taxable only to that person. The rule laid down by the Board of Tax Appeals in the instant case is in direct conflict with the rule laid down by this court in the case of *Helvering v. Hickman*, supra.

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THE CONTRACT INVOLVED TERMINATED PETITIONER'S  
COMMUNITY INTEREST IN HER HUSBAND'S FUTURE  
EARNINGS.

In addition to declaring that the petitioner could not by contract terminate her community interest in the



future earnings of her husband, the Board declared that by its own terms the contract here involved did not do so. A question of construction of the agreement of the petitioner and her husband (Transcript pp. 29-32) is therefore involved in this appeal. In this connection, the contract as a whole, the surrounding circumstances and the object of the agreement must be looked to and taken into account in determining the intention of the parties. If the provisions of the contract as a whole are susceptible of an interpretation which will give effect to the mutual lawful intention of the parties, as it is thus found to have existed at the time of contracting, the court is bound to give them that interpretation.

*Lemm v. Stillwater Land & Cattle Co.*, (1933)  
217 Cal. 474, at pp. 480-1.

The contract counted upon is a separation agreement made between the petitioner and her husband in 1926, when they ceased living together (Transcript pp. 29-32). While the agreement was somewhat modified thereafter (Transcript pp. 33-35), the modification is of no importance in this determination. This is not a situation in which husband and wife living together attempt by contract for the purpose of convenience to shift tax liabilities. The record is clear that the petitioner and her husband have lived separate and apart ever since the date of the execution of their agreement in 1926. It is further clear that while the husband agreed to pay the petitioner \$1,000 a month as support for her and the three minor children of the marriage, he has failed to carry out this part of his

agreement, to the end that the petitioner finds herself in a position of being taxed with one-half of her husband's earnings in the year 1929, when she has not only severed her community interest in his earnings but further, when he has failed to support her or her children.

There is no dispute between the parties to the agreement. The separation agreement was one in which they both sought to make a division of all of their property interests, both real and personal, and to provide for the care and support of the petitioner and the children of the marriage. As testified by the petitioner and confirmed by her husband (Transcript pp. 50-51), both intended by the agreement "to make a complete division" of their property rights, terminating their "community interest in any property then existing and in his (the husband's) earnings and salary thereafter". They both considered that the effect of the contract was to sever their community interest in the husband's salary. They not only so testified in this case, but by their conduct they so construed the agreement. The husband, in his own individual tax return for the year in question, returned and paid a tax on the whole of his salary (Transcript p. 50), and your petitioner, accordingly, did not return any part of the salary (Transcript p. 55). The testimony of the parties as to their intention in executing the separation agreement was relevant and properly received by the Board and may be looked to in construing the separation agreement (*Nolan v. Nolan*, 155 Cal. 476, at p. 482; *Ruiz v. Dow*, 113 Cal. 490, at p. 497), and the

construction placed upon the contract by the conduct of the parties is particularly significant in the determination of the meaning of the agreement. As was said in *Storm & Butts v. Lipscomb* (1931), 117 Cal. App. 6, at p. 15:

“At the trial of the case the plaintiffs were permitted to show by oral testimony that the plans and specifications were from the inception of the contract accepted by Lipscomb & Dutton as the basis of all their dealings on the subject matter, that they formed the basis of their bid and were consulted during the construction of the work. The plaintiffs do not seek to contradict by parol proof the covenants of the contract in question. ‘In its execution, every executory contract requires more or less of a practical construction to be given it by the parties, and when this has been given, the law, in any subsequent litigation which involves the construction of the contract, adopts the practical construction of the parties as the true construction, and as the safest rule to be applied in the solution of the difficulty’ (*Mitau v. Roddan*, 149 Cal. 1 (6 L. R. A. (N. S.) 275), 84 Pac. 145)”.

See also:

*Mitau v. Roddan*, 149 Cal. 1, at pp. 14-16;

*Hansen v. D'Artenay*, 121 Cal. App. 746, at pp. 756-7.

We submit further that so long as the parties to the agreement are in accord as to its interpretation that it does not lie in the power of the Commissioner to

place a different construction thereon so that he can collect, in the aggregate, a greater tax from both parties.

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**CONCLUSION.**

In conclusion, we respectfully submit:

(a) that an agreement between husband and wife residing in California, terminating their community interest in community property, including future earnings of the husband, is valid and effective; and

(b) that your petitioner and her husband did by their separation agreement of May 12, 1926, so terminate their community interest in the future earnings of the husband, and that therefore no part thereof subsequent to the date of the agreement, which includes the taxable year in question, 1929, can be taxed to her.

Respectfully submitted,

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E. D. TURNER, JR.,

*Attorneys for Petitioner.*